

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

## LEXINGTON INSURANCE CO.,

Plaintiff,

V.

SANDRA SWANSON,

## Defendant.

No. C05-1614MJP

**ORDER GRANTING IN PART AND  
DENYING IN PART  
DEFENDANT'S MOTION FOR  
SUMMARY JUDGMENT**

This matter comes before the Court on Defendant Swanson's motion for partial summary judgment. (Dkt. No. 100.) Defendant Sandra Swanson as assignee of Issaquah Care Center ("ICC") has moved for partial summary judgment seeking to dismiss Plaintiff Lexington Insurance Company's ("Lexington") affirmative defenses to Swanson's counterclaims in this insurance coverage case. Having considered Defendant's motion, Plaintiff's response (Dkt. No. 129), Defendant's reply (Dkt. No. 140), Plaintiff's surreply (Dkt. No. 144), all documents submitted in support thereof, and the record herein, the Court GRANTS IN PART and DENIES IN PART Swanson's motion for partial summary judgment.

## Background

Defendant Swanson filed a personal injury action against ICC on March 21, 2003, for claims arising out of the negligent care she received during her stay at a ICC's nursing home. (Beninger Decl., Ex. 1.) ICC tendered defense of the lawsuit to Lexington on April 17, 2003. (See id. at Ex. 2,

1 18.) In early June, Swanson made an offer to settle the case for the policy limits.<sup>1</sup> (*Id.* at Ex. 3;  
 2 Sobers Decl. Ex. 2.) Bradley Reager, Lexington's claims analyst, concluded that the case could  
 3 potentially create liability for ICC in excess of Lexington's policy limits and suggested that ICC retain  
 4 independent counsel. (Beninger Decl., Ex. 5.) Diane Libby, counsel hired to represent ICC, also  
 5 agreed that the case involved a possible likelihood of liability. (Beninger Decl., Ex. 7, at 6.)  
 6 However, Lexington did not agree to settle because Reager and Libby concluded that they needed to  
 7 evaluate Swanson's claims further before making any settlement decisions. (*Id.*, Ex. 7.)

8 The Lexington policy issued to ICC had a \$1 million per incident limit with a maximum  
 9 coverage of \$3 million. (*Id.*, Ex. 4.) The policy also contained endorsements, including a "spend-  
 10 down" clause, which placed a cap on the total funds available to pay out any claims. (*Id.*, Ex. 4.) The  
 11 clause operated by including Lexington's defense expenses in the policy limits, so that every dollar  
 12 spent on defending the action reduced the amount available to ICC to pay any future settlement or  
 13 judgment. (*Id.*) Another endorsement was a \$100,000.00 self-insured retention provision. (*Id.*)

14 In September 2003, Swanson brought additional claims against Haelen Health Systems  
 15 ("Haelen"), the administrator of ICC's nursing home. (*Id.*, Ex. 8.) Haelen filed cross-claims against  
 16 ICC for indemnification. (Sobers Decl., Ex. 6, at 22-24.) ICC retained Mary Nester as independent  
 17 counsel to handle the Haelen cross-claim. (Beninger Decl., Ex. 9.) Although Nester did not represent  
 18 ICC for Swanson's underlying claim, she had access to the available discovery materials, and on April  
 19 7, 2004, Nester wrote a letter to Scott Barbara, another attorney retained by Lexington to represent  
 20 ICC against Swanson, requesting a policy limit settlement offer. (*Id.*, Ex. 9.) Around that time,  
 21 Barbara and Reager reached the same conclusion. (*Id.*, Ex. 10.) They determined that the probable  
 22 net exposure for ICC was in the range of \$1.82 million to \$3.36 million. (*Id.* at 10.) In a May 31,  
 23 2004, litigation plan, Barbara wrote, "[w]e now have sufficient information based upon the records  
 24 reviewed to recommend the full limits of ICC's policy be made available to settle this case." (*Id.*)

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25  
 26 <sup>1</sup> Although Lexington disputes that the letter sent by Swanson on June 3, 2003, was an offer  
 to settle the case, a second letter sent by Swanson later that month confirmed that it was an offer,  
 (Beninger Decl., Ex. 3) and ICC's attorneys considered it a settlement offer. (Sobers Decl., Ex. 2.)

1 Because Reager had been replaced by another claims adjuster between the time he met with Barbara  
2 and the drafting of the litigation plan, Barbara sent the plan to Reager's replacement, Blair Winston,  
3 for review. (Id.)

4 On May 17, 2004, Swanson scheduled a mediation between the parties for June 1, 2004.  
5 (Neal Decl., Ex. 4.) The following day, Libby notified Swanson that ICC would be unavailable on  
6 that date, and requested that the mediation be rescheduled. (Id.) Nevertheless, the June 1 mediation  
7 went forward and Barbara attended the mediation on behalf of ICC. (Beninger Decl., Ex. 11.)  
8 Swanson reiterated the policy limits settlement offer at that mediation. (Neal Decl., Ex. 1, at 26-27.)  
9 Although Barbara had recommended that Lexington settle the case for policy limits, the parties did  
10 not resolve the case at the mediation. (Neal Decl., Ex. 1, at 27.) In July 2004, the new claims  
11 adjuster, Winston, indicated that although Swanson had made a policy limits demand, the "policy has  
12 not yet been triggered since the [self-insured retention] has neither been tendered nor exhausted."  
13 (Beninger Decl., at Ex. 12.)

14 On July 21, 2004, Nester again wrote to Libby requesting a policy limits settlement. (Id., Ex.  
15 13.) The following month, Libby wrote to Swanson, indicating that prior to any settlement Swanson  
16 must first provide expert reports and opinions supporting her claims. (Neal Decl., Ex. 8.) In  
17 September, Barbara wrote to Swanson, indicated that ICC had received some evidence from  
18 Swanson's expert witnesses, and announced that ICC had been authorized to settle the case for the  
19 full policy limits of \$1 million. (Neal Decl., Ex. 7, at 2.) The offer was extended in writing in advance  
20 of a mediation scheduled to take place in mid-October. (Neal Decl., Ex. 1, at 28.) At the mediation,  
21 Swanson declined to settle for \$1 million less litigation expenses, and for the first time argued that the  
22 maximum \$3 million "should be in play" because each of her injuries were separate incidents. (Id. at  
23 30.) The parties failed to reach an accord. (Id.)

24 Following the mediation, Lexington retained coverage counsel to determine whether ICC was  
25 entitled to coverage for the maximum amount of the policy. (Beninger Decl., Ex. 17, at 3.) They  
26 concluded that the facts supported single incident coverage only, and orally informed Barbara and

1 Libby that the policy limit was \$1 million. (*Id.*) On approximately June 20, 2005, counsel for the  
 2 various defendants met and advised Lexington that full exposure in the case was likely between \$4  
 3 million and \$6 million. (*Id.*) On June 21, 2005, Lexington's coverage counsel provided a letter  
 4 confirming their opinion that the facts supported single incident coverage only, and reserved all rights.  
 5 (*Id.*; Beninger Decl., Ex. 15) At the mediation, Swanson again refused to settle for the single incident  
 6 policy limits of \$1 million. (Beninger Decl., Ex. 17, at 3.)

7 In August 2005, Swanson and ICC agreed to arbitrate their dispute. (*Id.*) On August 19,  
 8 Lexington sent a letter to Barbara in which it did not object to the arbitration, but reserved its right  
 9 not to be bound by the outcome of the arbitration proceeding. (*Id.*, Ex. 16, at 2.) Lexington also  
 10 reserved the right to contest coverage in the event ICC entered into a settlement agreement without  
 11 Lexington's consent, or assigned its interests against Lexington. (*Id.*) At the arbitration, Swanson  
 12 was awarded damages of \$6 million. (*Id.*, Ex. 17, at 6.) Lexington did not pay the full judgment, but  
 13 in December 2005, forwarded payment of \$580,000.00 to Swanson, labeling the check "Full and  
 14 Final Payment." (Neal Decl., Ex. 10.) Swanson returned the check and requested a new check  
 15 without the additional language. (Beninger Decl., Ex. 19.) Shortly thereafter, Lexington issued a new  
 16 check without the additional language. (*Id.* at 2.)

17 The present case has a tortured procedural history. The relevant proceedings began when  
 18 Swanson sought to enforce the arbitration award against ICC in Washington State superior court.  
 19 See Swanson v. Issaquah Care Center, LLC, No. 03-2-20442-1SEA. Thereafter, when Swanson  
 20 amended her complaint to include Lexington as a defendant, Lexington removed the case to federal  
 21 court. (CV06-005 RSL, Dkt. Nos. 1-3.) Prior to removal of Swanson's state court action, Swanson  
 22 purchased ICC's choses in action against Lexington at a Sheriff's sale of ICC's assets. (*Id.*, Dkt. No.  
 23 2, Ex. 3.) Swanson then amended her complaint to include claims against Lexington as ICC's  
 24 assignee. (*Id.*, Ex. 8.) On January 11, 2006, Lexington filed an answer to Swanson's complaint,  
 25 raising several affirmative defenses. (*Id.*, Dkt. No. 5.)

26

At the same time, the present lawsuit filed by Lexington was pending before this Court. (Dkt. No. 1.) Lexington filed this suit against ICC seeking, among other things, a declaratory finding that ICC was entitled to single incident coverage only. (*Id.*) The Court consolidated the two federal cases on Lexington's motion, terminated the removed case, and ordered Swanson to file an answer to Lexington's complaint with any counterclaims within sixty days. (Dkt. Nos. 33-34.) On May 17, 2006, Swanson filed an answer with counterclaims that were nearly identical to the claims she raised in the complaint terminated by the motion to consolidate. (Dkt. No. 39.) Finally, on October 24, 2006, Lexington filed an answer to Swanson's counterclaims. (Dkt. No. 73.) With one exception, each of the nineteen affirmative defenses raised in Lexington's answer were raised in Lexington's answer to Swanson's original complaint.

Swanson now moves to dismiss Lexington's affirmative defenses to Swanson's counterclaims. Swanson has also moved to strike material contained in Lexington's response. Lexington opposes Swanson's motion and has moved to strike material contained in Swanson's reply. Lexington also requests a rule 56(f) continuance on any claims made by Swanson relating to ICC's defense of cross-claims filed by Haelen in the previous state court action.

## Discussion

### I. Summary Judgment Standard

Summary judgment is appropriate when there is no genuine issue as to material facts and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56. The party seeking summary judgment bears the initial burden of informing the court of the basis for its motion, and of identifying those portions of the pleadings and discovery responses that demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Where the moving party will have the burden of proof at trial, it must affirmatively demonstrate that no reasonable trier of fact could find other than for the moving party. *Calderone v. United States*, 799 F.2d 254, 259 (6th Cir. 1986). On an issue where the nonmoving party will bear the burden of proof at trial, the moving party can prevail merely by pointing out to the district court that there is an

1 absence of evidence to support the nonmoving party's case. Catrett, 477 U.S. at 325. If the moving  
 2 party meets its initial burden, the opposing party must then set forth specific facts showing that there  
 3 is some genuine issue for trial in order to defeat the motion. Anderson v. Liberty Lobby, 477 U.S.  
 4 242, 250 (1986).

5 **II. Rule 56(f) Continuance**

6 Lexington has requested a continuance pursuant to Fed. R. Civ. P. 56(f), arguing that  
 7 Swanson is attempting to plead a new claim through her summary judgment briefing. Rule 56(f)  
 8 provides:

9 Should it appear from the affidavits of a party opposing the [summary judgment] motion  
 10 that the party cannot for reasons stated present by affidavit facts essential to justify the  
 11 party's opposition, the court may refuse the application for judgment or may order a  
 12 continuance to permit affidavits to be obtained or depositions to be taken or discovery  
 13 to be had or may make such other order as is just.

14 Fed. R. Civ. P. 56(f). Lexington argues that Swanson is attempting to assert a claim for coverage of  
 15 the costs incurred by ICC defending the cross-claim made by Haelen in the state court proceeding.  
 16 Lexington seeks a continuance so that it may perform further discovery on this issue before the Court  
 17 issues a ruling. But none of the affirmative defenses that Swanson is seeking to dismiss from  
 18 Lexington's answer relate to the Haelen cross-claim and Lexington does not explain how further  
 19 discovery would help it respond to this motion. Because Swanson is not seeking summary judgment  
 20 on any issues related to the Haelen cross-claim, the Court DENIES Lexington's request for a Rule  
 21 56(f) continuance.

22 **III. Affirmative Defenses**

23 Swanson has moved for summary judgment dismissal of all of Lexington's affirmative  
 24 defenses. Swanson challenges all of the affirmative defenses on timeliness grounds. In the  
 25 alternative, Swanson raises specific challenges to individual affirmative defenses.

26 **A. Timeliness**

27 Relying on Fed. R. Civ. P. 16(b), Swanson argues that Lexington's affirmative defenses  
 28 should be dismissed as untimely because Lexington did not file an answer to Swanson's counterclaims

until three months after the Court-ordered deadline for amending the pleadings. But Lexington filed a responsive pleading, not an amended pleading. Because the Court did not set a Rule 16(b) deadline for responsive pleadings, Lexington’s answer was not untimely under Rule 16(b).

4 Swanson also argues that the Court should dismiss all of Lexington's affirmative defenses  
5 because Lexington filed its answer more than twenty days after the deadline for responsive pleadings  
6 in violation of Fed. R. Civ. P. 12(a)(2). But absent a showing of prejudice, a defendant may raise an  
7 affirmative defense for the first time at summary judgment. Camarillo v. McCarthy, 998 F.2d 638,  
8 639 (9th Cir. 1993); see also Draper v. Coombs, 792 F.2d 915, 924-25 (9th Cir. 1986) (affirming  
9 denial of default judgment because plaintiff did not show that defendant's failure to file timely answer  
10 in compliance with federal rules resulted in any prejudice). Here, Swanson has made no showing of  
11 prejudice resulting from Lexington's late filing of the answer. Moreover, when a plaintiff receives  
12 notice of an affirmative defense by some means other than the pleadings, the defendant's failure to  
13 comply with the pleading requirements of Fed. R. Civ. P. 8(c) does not cause the plaintiff any  
14 prejudice. Moore, Owen, Thomas & Co. v. Coffey, 992 F.2d 1439, 1445 (6th Cir. 1993) (citing  
15 Grant v. Preferred Research, Inc., 885 F.2d 795, 797 (11th Cir. 1989)). Swanson had notice of  
16 Lexington's affirmative defenses because prior to the consolidation of the actions, Lexington filed an  
17 answer to Swanson's complaint that included all but one of the affirmative defenses raised in the  
18 second answer.<sup>2</sup> (CV06-005 RSL, Dkt. No. 5.) In addition, some of the defenses raised by Lexington  
19 are identical or substantially related to Lexington's affirmative claims for relief in the declaratory  
20 judgment action. (See Dkt. No. 14.) As a result, Swanson was aware, or should have been aware,  
21 that Lexington would rely on these defenses. If Swanson believed that she did not have sufficient  
22 notice of Lexington's intended defenses, she could have filed a motion for default or objected in  
23 October 2006 when Lexington filed its late answer. Because Swanson has not shown any prejudice,  
24 the Court denies Swanson's motion as it pertains to the timeliness of Lexington's answer.

<sup>2</sup> Lexington admits that Affirmative Defense No. 18 is not an affirmative defense, but a reservation of the right to seek attorney's fees at the conclusion of the suit. This is a post-judgment remedy which need not be addressed by the Court at this time.

1           **B. Challenges to Affirmatively-Plead Contract Defenses to Coverage**

2 Lexington has alleged ten affirmative defenses that are contract defenses to coverage. (Dkt.  
 3 No. 73, Affirmative Defenses Nos. 1-4, 9-13, 15.) Swanson contends that these ten contract defenses  
 4 to coverage are barred under Washington law because Lexington failed to reserve its right to raise  
 5 those defenses. Unless an insurer notifies the insured that it intends to contest coverage, the insurer's  
 6 continued control of the defense constitutes a waiver of the right to challenge coverage at a later date.  
 7 Van Dyke v. White, 55 Wn.2d 601, 607-08, 349 P.2d 430 (1960). Such notification is known as a  
 8 "reservation of rights." See Truck Ins. Exch. v. Vanport Homes, Inc., 147 Wn.2d 751, 761, 58 P.3d  
 9 276 (2002). But absent evidence of prejudice or bad faith, the insurer is not estopped from raising  
 10 coverage defenses merely because it failed to notify the insured of all coverage defenses. See Hayden  
 11 v. Mut. of Enumclaw Ins. Co., 141 Wn.2d 55, 63, 1 P.3d 1167 (2000).

12 As an initial matter, Lexington concedes in its briefing that many of the defenses plead as  
 13 "affirmative defenses" are not truly affirmative defenses.<sup>3</sup> (Plf.'s Resp. at 19-20.) Swanson does not  
 14 dispute this concession. Thus, the Court addresses these defenses, not as affirmative defenses for  
 15 which Lexington would bear the ultimate burden at trial, but as defenses to Swanson's counterclaims,  
 16 for which Swanson bears the burden of proof at trial.

17 Lexington disputes Swanson's interpretation of Washington reservation of rights law in two  
 18 respects. First, Lexington argues that Swanson did not allege that she had suffered any prejudice as a  
 19 result of Lexington's failure to reserve its rights earlier. Second, Lexington argues that it need not  
 20 issue a reservation of rights to protect its right to assert defenses related to policy limits or conditions  
 21 precedent to coverage. This latter argument relates to Affirmative Defenses Nos. 2 and 4, which the  
 22 Court will address separately.

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 26           <sup>3</sup> Lexington concedes that the following defenses are not true affirmative defenses:  
 Affirmative Defenses Nos. 1-6, 9-15, 17. These include all of Lexington's contract defenses to coverage.

1                   **1. Evidence of Prejudice**

2 Lexington argues that because Swanson failed to allege any prejudice, Lexington should not  
 3 be estopped from raising these coverage defenses. Swanson argues that she was prejudiced by  
 4 Lexington's management of ICC's defense. Lexington has moved to strike Swanson's arguments and  
 5 evidence regarding prejudice because Swanson presented them for the first time in her reply brief.  
 6 Lexington also challenges Swanson's prejudice arguments on their merits, claiming that it did not  
 7 control the litigation and that Swanson was not prejudiced.

8                   **a. Motion to Strike**

9 Lexington argues that several pages of argument and evidence in Swanson's reply motion  
 10 relating to waiver of coverage defenses should be excluded because those pages contain extensive  
 11 new argument and case authority. "Where new evidence is presented in a reply to a motion for  
 12 summary judgment, the district court should not consider the new evidence without giving the  
 13 [non-]movant an opportunity to respond." Provenz v. Miller, 102 F.3d 1478, 1483 (9th Cir. 1996).  
 14 Here it is unnecessary to strike a portion of the reply. The argument and authority raised by Swanson  
 15 in her reply relate to prejudice resulting from Lexington's control of the defense. Swanson addressed  
 16 the issues of prejudice and control of the defense in her original motion for summary judgment. (Mot.  
 17 at 10.) In addition, Swanson has offered the evidence relating to prejudice to reply to arguments in  
 18 Lexington's response. (See Resp. at 20-21.) Because the at-issue arguments and evidence reply to  
 19 arguments made in the response brief, and do not involve an entirely new argument raised for the first  
 20 time by Swanson in her reply, the Court denies Lexington's motion to strike.

21                   **b. Control of Litigation**

22 Swanson argues that ICC was prejudiced by the fact that Lexington controlled the  
 23 ICC-Swanson litigation for nearly two years before issuing a reservation of rights. In Washington,  
 24 courts presume that the insured has been prejudiced when the insurer has defended without a  
 25 reservation for ten months or more. Transamerica Ins. Group v. Chubb & Son, Inc., 16 Wn. App.  
 26 247, 252, 554 P.2d 1080 (1976); see also Safeco Ins. Co. v. Butler, 118 Wn.2d 383, 389, 823 P.2d

1 499 (1992). In its responsive brief, Lexington does not dispute that it controlled ICC's defense from  
 2 approximately April 2003 through June 2005.<sup>4</sup> Lexington also does not dispute that it did not issue a  
 3 reservation of rights until June 2005.<sup>5</sup> But at oral argument, counsel for Lexington argued that  
 4 Lexington did not control ICC's defense during this period. Counsel argued that the insured, ICC,  
 5 hired Michael Orber & Associates to manage its defense, and that Mr. Orber hired attorneys Libby  
 6 and Barbara from the Johnson, Christie, Andrews law firm as ICC's defense counsel.

7 Lexington's assertion at oral argument that it did not control ICC's defense is not itself  
 8 evidence that Lexington did not control the defense. Moreover, the assertion is contradicted by  
 9 evidence that both parties proffered throughout this case. For example, in support of a separate  
 10 motion for summary judgment, Lexington offered the declaration of Robin DuBrin, the managing  
 11 member of ICC. In that declaration, Dubrin stated:

- 12 1. "It is my opinion that Lexington Insurance Company's retained defense counsel, Johnson,  
   Christie, Andrews and Skinner, capably defended Issaquah Care Center, LLC against Mrs.  
   Swanson's claims." (DuBrin Decl. ¶ 3.)
- 14 2. "ICC was provided a full defense to the underlying suit brought by Swanson by Lexington  
   Insurance Company." (Id. ¶ 20.)

15 In addition, in support of its opposition to the present motion for summary judgment, Lexington  
 16 offered the Declaration of Earl Sutherland, an attorney retained by Lexington to oversee the  
 17 Swanson-ICC lawsuit. Sutherland points to a letter he wrote to ICC's corporate counsel, Mary  
 18 Nester, in August 2004, in which he stated:

19 Lexington is cognizant of its duties to your client. Lexington will thoroughly  
 20 investigate all liability and damages issues involved in the claim. It has retained  
 21 competent defense counsel. The company, as well as the Johnson Christie law firm,  
 and its lawyers, recognize that only Issaquah Care Center is their client. From what

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22         <sup>4</sup> Lexington does dispute that it controlled ICC's defense of the Haelen cross-claim, but that  
 23 dispute is irrelevant to Swanson's challenge of Lexington's affirmative defenses.

24         <sup>5</sup> Lexington does argue that it reserved its rights regarding policy limits in 2004. (See Plf.'s  
 25 Resp. at 6; Sutherland Decl., Ex. 1.) That argument is addressed in Section III.B.2 below. Lexington  
 26 also argues that it informed ICC of the \$100,000.00 SIR. Lexington points to a letter from Lexington  
 attorney Earl Sutherland in August 2004, more than sixteen months after Lexington assumed control of  
 ICC's defense, in which Sutherland informs ICC corporate counsel Mary Nester of the SIR. (Sutherland  
 Decl., Ex. 1.)

1 we have seen, the law firm has kept Issaquah Care Center fully informed of the  
 2 progress of the lawsuit.

3 Lexington will continue to diligently investigate and evaluate the claims in this case. .  
 4 . . Under the Lexington Insurance Company policy no. 6790096, however, your  
 5 client has a contractual obligation to pay the first \$100,000.00 in indemnity and/or  
 6 defense costs.

7 (Sutherland Decl., Ex. 1.) Moreover, in September 2005, Scott Barbara sent Chris Neal, counsel for  
 8 Lexington, a letter in which he stated as follows: "Our office was retained by AIG to represent the  
 9 best interests of its insured, ICC, LLC."<sup>6</sup> (Beninger Decl., Ex. 18.) And in his March 20, 2007,  
 10 deposition, Barbara had the following exchange with Swanson's attorney:

11 Q: When you do, though, talk about Lexington stepping down at some point in  
 12 time to begin payment, Lexington had always been involved from the beginning  
 13 of the claim, as you understand, under the litigation-management program to  
 14 coordinate and be involved in the defense and evaluation of the claims, correct?

15 A: Yes.

16 Q: Were you ever told that Lexington didn't feel its defense obligations or its  
 17 necessity of being involved in developing the agreed-to litigation plans weren't  
 18 triggered until ICC first paid \$100,000?

19 A: I don't recall ever being told that. And prior to my time, I don't recall there  
 20 being any documents in the file to that effect.

21 Q: The actions of Lexington/AIG from the inception of the case was one, though,  
 22 of not waiting to be triggered, but to be actively involved in the control and  
 23 planning of the defense in accordance with the litigation-management program,  
 24 correct?

25 A: We were communicating and coordinating with the claims professionals  
 26 throughout, from the inception.

27 (Supp. Beninger Decl., Ex. A, Barbara Dep. at 97-98.) This evidence belies Lexington's assertion at  
 28 oral argument that it did not control ICC's defense during the period from April 2003, when Swanson  
 29 brought her initial suit against ICC, through June 2005, when Lexington issued its reservation of  
 30 rights.

31 Swanson also argues that she was prejudiced because Lexington retained control over ICC's  
 32 defense despite several conflicts of interest. In support of her argument, Swanson cites four examples  
 33 of Lexington's conflicts, including (1) the use of litigation management plans requiring pre-approval  
 34 of all decisions made by ICC's defense counsel, including the decision to settle the case, by

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26 <sup>6</sup> AIG is the claims handling agency for Lexington Insurance Company. (Dkt. No. 53,  
 27 Sobers Decl. ¶ 1.)

1 Lexington's insurance adjusters; (2) the spend-down provision of ICC's policy with Lexington; (3)  
 2 the policy's self-insured retention provision; and (4) Lexington's rejection of multiple policy limits  
 3 settlement opportunities. (Reply at 8-9.)

4 Litigation management plans create a potential conflict because they permit an insurer to  
 5 wield a veto over settlement decisions despite the recommendation of the insured's counsel. In this  
 6 case, at least once, Lexington refused to settle for policy limits despite ICC counsel's  
 7 recommendation. (See Beninger Decl., Ex. 10-12.) In addition, spend-down policies create a  
 8 potential conflict of interest. "Insurers can be placed in potential or real conflict situations under a  
 9 [spend-down] policy when they attempt to control the insured's defense." Baldwin, Legal and Ethical  
 10 Considerations for "Defense within Limits" Policies, 61 Def. Counsel J. 89 (1994). The conflict  
 11 arises because although the insured may wish to settle to avoid any excess liability, the insurer has an  
 12 interest in defending the suit to avoid liability entirely. In the event the insurer should lose, it has the  
 13 same liability as if it had paid a policy limits settlement offer.

14 Lexington's control of the litigation defense for nearly two years before issuing a reservation  
 15 of rights raises a presumption that its insured was prejudiced. See Transamerica, 16 Wn. App. at 252.  
 16 Lexington has not rebutted this presumption. It has offered no evidence suggesting that ICC was not  
 17 harmed by its failure to issue a timely reservation of rights. And Swanson, on behalf of ICC, has  
 18 offered evidence that ICC was prejudiced not only by the late reservation, but also by conflicts of  
 19 interest created by Lexington's method of controlling the litigation. Thus, because Lexington did not  
 20 issue a reservation of rights until after it had controlled the defense for almost two years, because  
 21 Lexington has presented no evidence rebutting the presumption of prejudice, and because ICC has  
 22 presented evidence indicating that it was prejudiced, Lexington has waived eight of its contract  
 23 defenses to coverage, Affirmative Defenses Nos. 1, 3, 9-13, and 15. Those affirmative defenses are  
 24 therefore dismissed. Lexington may not rely on those defenses as affirmative defenses or as legal  
 25 defenses to Swanson's bad faith, negligence, or other counterclaims.

26

1                   **2.       No Reservation Necessary to Assert Policy Limits, but Necessary to Assert  
2                   Conditions Precedent to Coverage**

3                   Lexington argues that it did not need to reserve rights with respect to its policy limit or  
4                   conditions precedent to coverage defenses.<sup>7</sup> An insurer need not issue a reservation of rights letter to  
5                   its insured in order to limit its risk to the policy limit. See Thomas V. Harris, Washington Ins. Law §  
6                   17.1 (2d ed. 2006) (“By providing its insured with policy limit information, an insurer is attempting to  
7                   protect itself against a bad faith claim rather than protecting its right to deny that the policy applies to  
8                   the claim.”) In the present case, Lexington does not claim that ICC is not entitled to coverage.  
9                   Indeed, Lexington has already paid Swanson the amounts remaining under the \$1 million single-  
10                  incident policy limit.<sup>8</sup> Instead, Lexington is merely disputing the applicable policy limit. Because  
11                  Lexington did not need to reserve its rights with respect to the applicable policy limit, the Court will  
12                  not dismiss Affirmative Defense No. 4.

13                  Lexington also argues that it need not reserve rights with respect to the policy’s conditions  
14                  precedent to coverage. In so arguing, Lexington relies on an insurance treatise for the proposition  
15                  that conditions precedent to coverage are not waived when the insurer has failed to defend. 14 Lee  
16                  R. Russ et al., Couch on Insurance, ¶ 202.13 (2005). But in the present case, Lexington assumed  
17                  defense of the claim. In so doing, without issuing a reservation of rights as to conditions precedent to  
18                  coverage, Lexington failed to preserve the right to contest coverage at a later date. See Van Dyke, 55  
19                  Wn.2d at 607-08. For the same reasons discussed in section III.B.1.b above, the Court dismisses  
20                  Affirmative Defense No. 2.

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22                  <sup>7</sup> These are Affirmative Defense Nos. 4 and 2, respectively.

23                  <sup>8</sup> In support of its argument regarding policy limits, Lexington submitted a declaration with  
24                  attached exhibits from Earl Sutherland, a Lexington attorney. (Dkt. No. 131.) Swanson moved to strike  
25                  that testimony and evidence, arguing that Lexington should be barred from using this information as  
26                  evidence where Lexington previously refused to disclose information relating to advice or  
communications from Sutherland. Because the Court does not rely on the Sutherland declaration in  
resolving this issue, the motion to strike is moot. And even if the motion were not moot, it would be  
denied because (a) Swanson failed to cite where Lexington previously asserted this privilege; and (b) in  
fact, Lexington never asserted privilege as to these particular documents.

1                   **C. Challenges to Miscellaneous Affirmative Defenses**

2                   **1. Affirmative Defense No. 7 — Waiver/Estoppel/Laches**

3 Lexington's seventh affirmative defense states as follows: "Swanson's claims are barred, in  
 4 whole or in part, by the doctrines of waiver, estoppel, and/or laches." (Dkt. No. 73.) Swanson argues  
 5 that these defenses are frivolous. To assert waiver, Lexington must show that Swanson/ICC  
 6 intentionally and voluntarily relinquished its right to recover any insurance proceeds. See Jones v.  
 7 Best, 134 Wn.2d 232, 241-42, 950 P.2d 1 (1998). To assert an estoppel defense, Lexington must  
 8 show that it justifiably relied on a promise by Swanson/ICC that it would not seek coverage for ICC's  
 9 losses. See id. at 239. Finally, to assert a laches defense, Lexington must show that Swanson/ICC  
 10 knew it had a cause of action against Lexington for coverage but that it delayed seeking coverage and  
 11 that the delay prejudiced Lexington's defense. See Davidson v. State, 116 Wn.2d 13, 25, 802 P.2d  
 12 1374 (1991). Lexington does not address the waiver and estoppel defenses in its response.  
 13 Lexington has presented no evidence that Swanson intentionally and voluntarily relinquished her right  
 14 as ICC's assignee to recover insurance proceeds. To the contrary, Swanson has spent considerable  
 15 time and resources in her efforts to recover funds owed to ICC. Moreover, Lexington has not  
 16 presented any evidence that ICC or Swanson promised to not seek coverage or that Lexington has  
 17 suffered any prejudice. In addition, the filing of this declaratory judgment action shortly after  
 18 Swanson won the arbitration with ICC is evidence that Lexington did not rely on any promises by  
 19 Swanson not to seek coverage. Because Lexington has not presented any argument or evidence in  
 20 support of its waiver or estoppel defenses,<sup>9</sup> and because the record suggests that neither of these  
 21 defenses are viable, the Court dismisses Lexington's waiver and estoppel defenses.

22 Lexington argues that Swanson's counterclaims are barred by the doctrine of laches because  
 23 Swanson caused the delay in settling the case when she (1) made an early demand for policy limits  
 24 without offering any evidence to support her claim; (2) failed to provide expert testimony despite

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 26                   <sup>9</sup> The Court may consider Lexington's failure to respond to Swanson's argument on these  
                      two issues as an admission that Swanson's argument has merit. Local CR 7(b)(2).

1 repeated requests for the information; and (3) held a mediation without sufficient advance notice to  
 2 Lexington. But Lexington's argument confuses Swanson's capacity in this lawsuit. Lexington raised  
 3 the affirmative defenses in answer to the counterclaims made by Swanson as assignee for ICC.  
 4 Lexington's argument does not present any facts demonstrating that ICC was dilatory in raising any  
 5 claims against Lexington for coverage. Because Swanson's conduct in her individual capacity is  
 6 irrelevant to determining whether ICC's claims are barred by the doctrine of laches, and because  
 7 Lexington has failed to present any evidence regarding ICC's conduct in this regard, the Court  
 8 dismisses Lexington's laches defense.

## 9           **2.       Affirmative Defense No. 8 — Accord and Satisfaction**

10 Lexington's eighth affirmative defense states that Lexington has no obligations to Swanson to  
 11 the extent that Swanson's claims against Lexington are barred by accord and satisfaction. (Dkt. No.  
 12 73.) The defense of accord and satisfaction is met when the debtor tenders a check in full payment of  
 13 the debt which is then accepted by the creditor. U.S. Nat'l Bank Ass'n v. Whitney, 119 Wn. App.  
 14 339, 350, 81 P.3d 135 (2003). No accord is established where the amount owed remains open to  
 15 further negotiation. Id. at 351. In the present case, Swanson specifically rejected a check from  
 16 Lexington labeled "full and final payment," and demanded that the check be re-issued. (Beninger  
 17 Decl., Ex. 19.) Lexington complied with this request and re-issued the check without the additional  
 18 language. (Id.) In addition, at the time the check was tendered, the parties were involved in two  
 19 lawsuits addressing the coverage dispute. Therefore, the parties knew that the amount owed was  
 20 disputed and open to negotiation. Finally, Lexington admits in its response that its accord and  
 21 satisfaction defense applies only to damages paid in partial satisfaction of the judgment against ICC.  
 22 But Lexington has already preserved the right to seek a setoff for any payments made in partial  
 23 satisfaction of a judgment in its fourteenth affirmative defense. Because Lexington's accord and  
 24 satisfaction defense is superfluous and unsupported by any evidence, it is dismissed.

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1                   **3. Affirmative Defense No. 16 — Public Policy Considerations**

2 Lexington's sixteenth affirmative defense states: "Swanson's claims are barred, in whole or in  
 3 part, by public policy considerations." (Dkt. No. 73.) In its response, Lexington argues that this  
 4 affirmative defense "operates as a function of Washington law, and should not be dismissed." (Resp.  
 5 at 20.) In her reply, Swanson argues that Lexington has failed to present any legal support for this  
 6 defense and that its failure to do so is fatal to its public policy defense. But Swanson never moved on  
 7 this defense in her opening motion. The Court therefore declines to dismiss this defense.

8                   **Conclusion**

9                   The Court GRANTS IN PART and DENIES IN PART Swanson's motion for partial  
 10 summary judgment. First, the Court DENIES Lexington's motion for a rule 56(f) continuance. A  
 11 continuance is not warranted because none of the affirmative defenses at issue in this motion implicate  
 12 the Haelen cross-claim. Second, the Court DENIES Swanson's request to dismiss all of Lexington's  
 13 affirmative defenses on timeliness grounds. Third, the Court GRANTS Swanson's motion to dismiss  
 14 Affirmative Defenses Nos. 7 (waiver/estoppel/laches) and 8 (accord and satisfaction) because  
 15 Lexington has failed to produce evidence to support these defenses. But the Court will not dismiss  
 16 Affirmative Defense No. 16 (public policy) because Swanson failed to move on that defense in her  
 17 opening motion.

18                   Fourth, the Court DENIES both motions to strike. Swanson's motion is denied because it is  
 19 moot and because Swanson provided no evidence that Lexington ever claimed the Sutherland  
 20 testimony and documents at issue were privileged, and the exhibits are not privileged  
 21 communications. Lexington's motion is denied because the arguments and evidence raised by  
 22 Swanson in the reply brief are responsive to Lexington's motion and directly relate to issues raised in  
 23 Swanson's original motion.

24                   Finally, the Court GRANTS Swanson's motion to dismiss on nine of Lexington's contract  
 25 related Affirmative Defenses (Nos. 1-3, 9-13, 15) because Lexington controlled ICC's defense for  
 26 over two years without reserving the right to contest coverage. But the Court DENIES Swanson's

1 motion to dismiss Affirmative Defense No. 4 because Lexington does not need to reserve its rights  
2 with respect to policy limits.

3 Thus, the Court DISMISSES Affirmative Defenses Nos. 1-3, 7-13, and 15. Lexington may  
4 not advance these legal defenses either as affirmative defenses or as responses to Swanson's  
5 counterclaims.

6 The Clerk is directed to send copies of this order to all counsel of record.

7 Dated: May 23<sup>rd</sup>, 2007.

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10 Marsha J. Pechman  
United States District Judge

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